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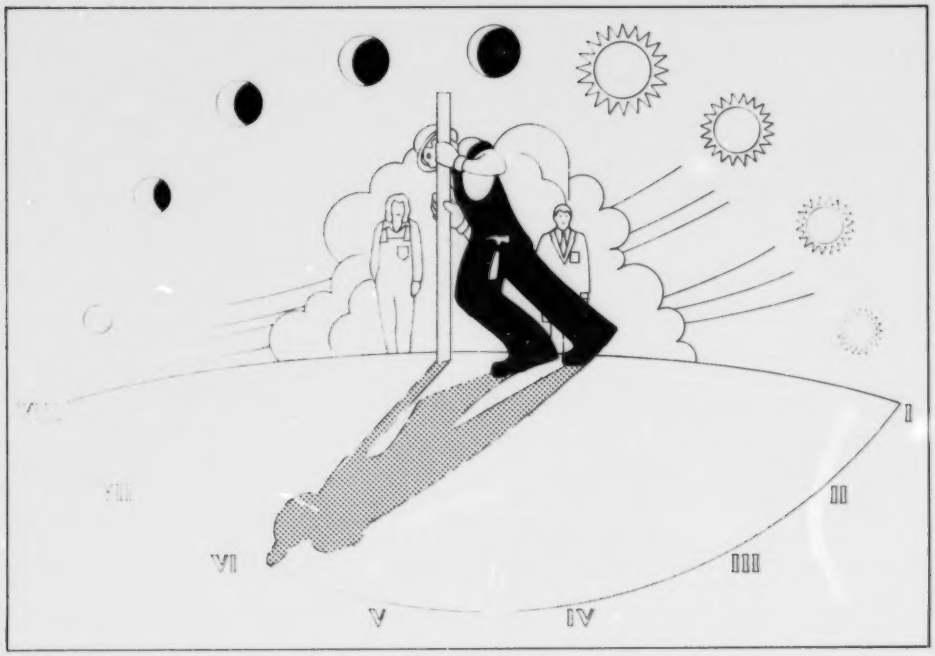

Hours of Work and Overtime Policies to Reduce Unemployment

HOURS OF WORK AND OVERTIME POLICIES TO REDUCE UNEMPLOYMENT

by

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(A Report Prepared for the Ontario Task Force on Hours of Work and Overtime)

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The views expressed in this report are those of the author and need not reflect the position of the Ontario Task Force on Hours of Work and Overtime.

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Abstract: Hours of Work and Overtime Policies to Reduce Unemployment

Voluntary worktime reduction policies are advocated to both increase the job satisfaction of current employees and to create jobs for the unemployed. Such changes would improve both equity and economic efficiency.

The most significant change recommended is amending the Ontario Employment Standards Act (ESA) to give employees an entitlement to voluntary worktime reductions with a proportionate reduction in pay. Survey evidence shows that 27 per cent of Ontario employees want such reductions in the form of jobsharing (reduced weekly hours), increased unpaid annual vacation or unpaid leaves.

The job creation potential is significant. For example, allowing voluntary jobsharing has the potential to create job openings equivalent to a 3.6 per cent increase in full-time employment.

Fringe benefit costs which are fixed per employee rather than per hour at work bias the employer towards long hours at work and reduced employment. Legislative changes are advocated to eliminate such bias in benefits provided in private employment contracts or in statutes (including vacation, holidays, pensions, unemployment insurance and workers' compensation).

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HOURS OF WORK AND OVERTIME POLICIES TO REDUCE UNEMPLOYMENT

INTRODUCTION

The objective of this report is to assess various policy options designed to combat unemployment by sharing employment; that is, by reducing hours of work, including overtime work. Possible policies to reduce work time include reductions in the standard workweek, increased annual vacation, increased use of jobsharing, increased accessibility of sabbatical leaves, and earlier retirement. Possible policies to reduce overtime include amending employment standards legislation concerning the overtime premium, the maximum hours of work allowed, the right to refuse overtime, paid time off as compensation for overtime work, and the criteria for granting overtime permits.

Potential policies will be evaluated on the basis of both efficiency and equity. Efficiency considerations include administrative costs, problems in achieving compliance, disruption to the normal allocative mechanism of the market, and flexibility to respond to changing circumstances. Equity considerations include the extent and the degree to which the target group is helped by the policy, and the extent and degree to which effects of the policy spill over to nontarget groups. The political acceptability of the policies to the parties involved and the government is also an important consideration.

THE RATIONALE FOR POLICIES TO REDUCE WORKTIME

Long-Run Trends in Work Time

Historically, working hours in Canada have decreased over the last century, as indicated by the data presented in Table 1 and illustrated in Figure 1. The standard workweek in manufacturing has declined from 64 hours per week in 1870 to under 40 hours per week in the 1980s, with substantial drops following World War I and World War II. Although the decline in the standard workweek has been very gradual since the late 1940s, there has been an increase in time off through public holidays and vacations. Adjusting the workweek for the increase in holidays and vacations reveals a continuing downward trend in annual working time, as illustrated in Figure 1.

The usual explanation for the decline in the standard workweek over time is that rising productivity and real wages have permitted an increased standard of living. The increase in living standards has been taken partly as an increase in real income (i.e., consumption of goods and services) and partly as an increase in leisure time. If productivity and real wages continue to rise in the future, the standard workweek is likely to continue to decline through changes in personnel practices, collective agreements and employment standards legislation.

Although the reduced worktime policies analyzed in this report complement the long-term improvement in quality of life through reduction in work hours, the policies are primarily directed toward alleviating the short-term lack of jobs in the economy.

TABLE 1

Standard Weekly Hours in Canadian Manufacturing, 1870-1985, Selected Years

Year	Hours	Year	Hours
1870	64.0	1963	40.3
1901	58.6	1964	40.2
1911	56.5	1965	40.2
1921	50.3	1966	40.2
1926	50.2	1967	40.0
1931	49.6	1968	39.9
1936	49.2	1969	39.9
1941	49.0	1970	39.8
1946	48.7	1971	39.8
1949	43.5	1972	39.7
1950	43.2	1973	39.6
1951	42.6	1974	39.5
1952	42.3	1975	39.4
1953	42.0	1976	39.4
1954	41.5	1977	39.3
1955	41.3	1978	39.3
1956	41.1	1979	39.3
1957	40.0	1980	39.3
1958	40.7	1981	39.2
1959	40.6	1982	39.2
1960	40.6	1983	39.2
1961	40.4	1984	39.2
1962	40.4	1985	39.3

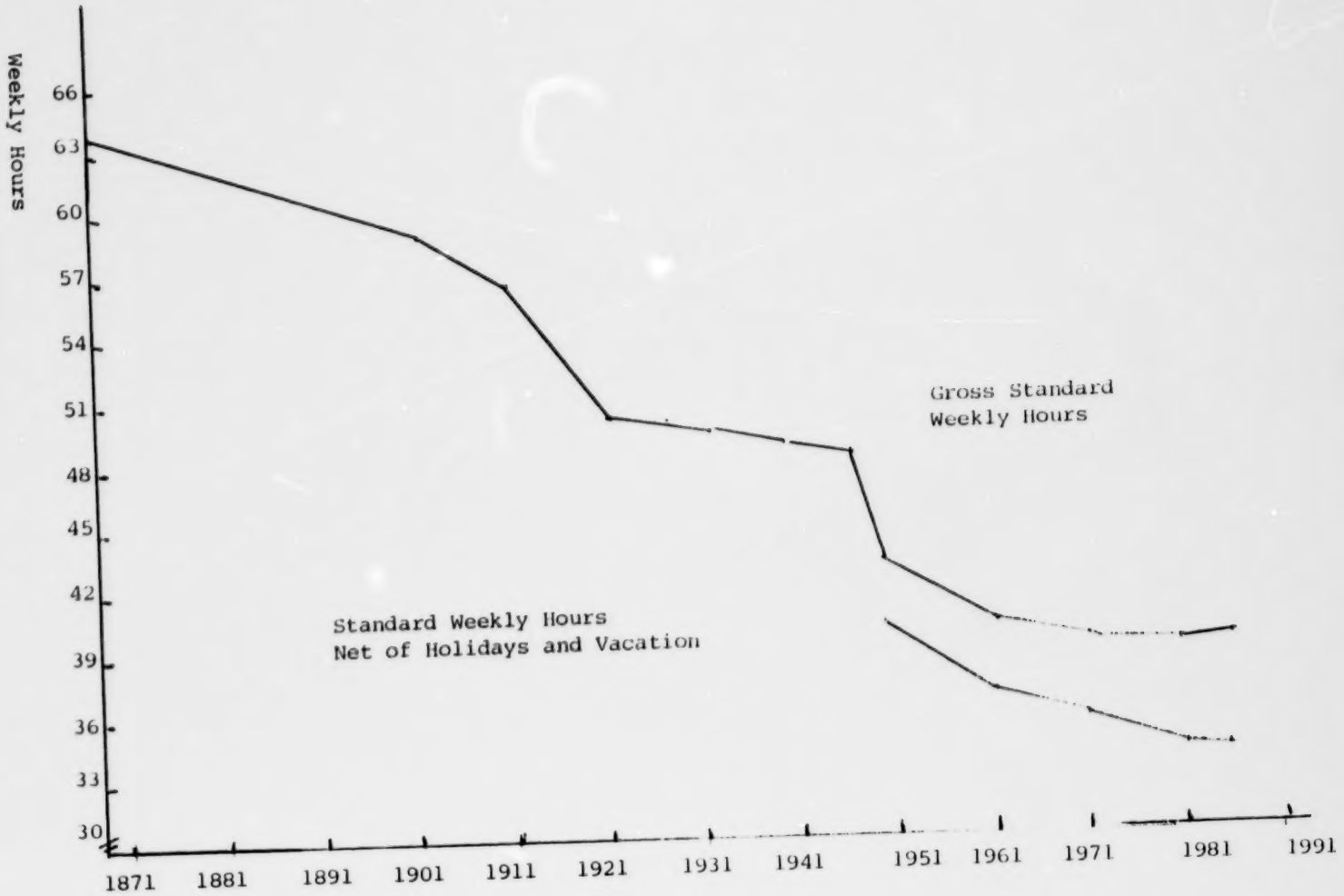
Sources:

1949-85 Calculations by Aw (1986) and Aw (1986) for Labour Canada using Working Conditions in Canadian Industry.

1901-46 Calculations by G. Saunders and S.M.A. Hameed using unpublished Labour Canada data, reported in Ostry and Zaidi (1979), p. 80.

1870 Calculations by O.J. Firestone, cited in Ostry and Zaidi (1979), p. 80.

FIGURE 1. Standard Weekly Hours in Canadian Manufacturing, 1870 to 1985



Source: Table 2.

Unemployment and the Lump-of-Labour Fallacy

If labour markets operated according to the textbook economic model of supply and demand, unemployment would not be a problem because the wage rate would adjust to equate the supply of labour and the demand for labour. The existence of severe and prolonged periods of unemployment in Canadian history indicates that wage rates obviously do not adjust quickly enough to clear the labour market. The reason for the "stickiness" of wages has been the subject of considerable debate in the macroeconomics literature. Explanations range from the suggestion by Keynes (1936) that wage rigidity reflects employees' concern with relative wages, to Okun's (1981) implicit contract theory in which rigidity reflects employers' concern about their reputation in the labour market. Since wage-rate adjustment, for whatever reason, cannot be relied upon to solve the unemployment problem, alternative government policies may be required.

The policies considered in this study are essentially attempts to create employment by redistributing a fixed amount of work. It may appear that such policies are based on the erroneous assumption that the total number of jobs in the economy is fixed, an argument which economists label the "lump-of-labour fallacy." In the long run, the number of jobs is not fixed because forces exist which eventually would move the economy to macroeconomic equilibrium at "full employment." Such forces may operate very slowly, however, so that severe unemployment can persist for an unacceptably long period.

In the short run, government could increase employment by adopting expansionary monetary and fiscal policies. Concern about the size of the budget deficit and inflation may, however, prevent such expansionary policies from being adopted. If full employment is

not achieved by appropriate macroeconomic policies, then, in the short run, policies to share the existing amount of work may provide a sensible approach to the unemployment problem.

Efficiency and the Employment-Hours Trade-Off

In establishing work schedules, employers attempting to minimize costs will have an incentive to take account of their employees' preferences regarding the length of the workweek. By establishing a schedule which conforms to the preferences of the majority of employees, the employer will increase employee job satisfaction, reduce turnover, and reduce costs (or reduce the need for a wage premium to retain valued employees).

In establishing work schedules, a cost-minimizing employer will compare the cost of hiring additional employees with the cost of increasing the hours of work of existing employees. The incentive to hire additional employees will increase according to the degree that fatigue reduces productivity, that overtime premiums are paid for hours beyond the standard workweek, and that administrative costs are involved in obtaining any permits required for overtime work. Three factors will increase the incentive to extend the hours of existing employees: higher quasi-fixed labour costs (such as hiring costs, training costs, and termination costs); substantial costs of benefits (such as health insurance premiums) that are at fixed amounts per person; and lower expectations regarding the length of stay of newly hired employees.

In making the cost-minimizing decision concerning the optimal level of employment, however, the employer and existing employees do not have an economic incentive to take account of the impact of their decision on unemployed workers. The unemployed have no adequate

means of making their interest in work schedules felt, given the rigidity of the wage rate and the failure of the labour market to clear. Furthermore, Canadian evidence (MacLaren et al. 1983, Canadian Mental Health Association 1984) indicates that unemployment and the threat of unemployment are associated with a variety of stress-related illnesses which impose real resource costs on the economy. In making their cost-minimizing decisions concerning work schedules, employers and existing employees have no incentive to take account of the costs of dealing with these illnesses, which are imposed on taxpayers in general.

The result is that decisions concerning work schedules, which may be efficient and cost-minimizing from the perspective of an individual firm, may be inefficient from the viewpoint of society as a whole. As a result of such externalities -- i.e. third-party effects -- government intervention to encourage reduced work time may be required on efficiency grounds.

The most important reason for government to encourage employment sharing is a concern for equity. In our society, employment is important not only for obtaining income, but also for maintaining self-esteem and dignity. Since work is such an important and valued commodity in our society, it is vital that it be distributed in an equitable manner.

VOLUNTARY WORK-TIME REDUCTIONS

Although standard work schedules normally reflect the preferences of the majority of employees, there will be a minority, perhaps a sizable minority, that wishes to work <u>less</u> than the standard work schedule, with a proportionate reduction in income. It seems particularly incongruous that at the same time that many unemployed

individuals want work and cannot obtain it, other employees are being required to work more hours than they desire to work. In this section, evidence will be presented on the number of Ontario employees who want to reduce their work time and the potential number of jobs that could be created through such reductions. This will be followed by an evaluation of policies which would facilitate work-time reductions by giving employees an entitlement to voluntary reduced work time through employment standards legislation.

Employee Attitudes Toward Reduced Work Time

The most comprehensive data on employee attitudes toward work reductions are from Statistics Canada's Survey on Work Reduction, which was undertaken as a supplement to the June 1985 Labour Force Survey, the source of the monthly unemployment figures. The sample was limited to employed paid workers 18 years of age and over who were not going back to school in the fall. Responses were received for 15,830 individuals. Using modified Labour Force Survey weights, which adjust for nonresponse, urban-rural status, and provincial and demographic factors, the results were extrapolated to the entire labour force.

Employees were asked: "In the next two years, would you take a pay cut if you received more time off in return?... Remember, for every hour less you work you would lose one hour's pay." Employees were also asked: "... would you trade some of your pay increase in the next two years for more time off? (For example, gain 5% more time off instead of a 5% pay raise?)" Employees who answered yes to either of these questions were then asked to indicate how much time off they would like in four alternative employment-sharing options: a reduced workday, a reduced workweek, increased annual vacation, and

the introduction of a sabbatical leave (i.e., an extended period of time off after a longer period).

The results presented in Table 2 indicate that over one million employees in Ontario (27 per cent of paid employees) want to reduce their work time with a proportionate reduction in pay.

In terms of specific employment-sharing options, 687,100 Ontario employees (18.3 per cent of paid employees) want to reduce their workweek by an average of 19.9 per cent of weekly hours. Detailed data presented in Table 3 indicate that a one-day-per-week reduction is the most popular magnitude of workweek reduction (favoured by 11 per cent of employees), with 4 per cent favouring a one-half-day reduction and 3 per cent favouring a reduction of more than one day.

Such workweek reductions could not all be converted into increased employment owing to scheduling problems, skill mismatches, induced productivity effects, and impacts on unit labour costs. Ignoring these qualifications for the moment, however, the evidence indicates that allowing employees who wish to reduce their workweek to do so has the <u>potential</u> to create an additional 136,700 full-time jobs (0.199 times 687,100). This is equivalent to a 3.6 per cent increase in paid employment, and, if achieved, would reduce the unemployment rate by a similar amount, a very substantial impact relative to the unemployment rate in Ontario.

Similarly, Table 2 indicates that 376,400 Ontario employees (10 per cent of total employees) wish to reduce their <u>workday</u> by an average of 17 per cent. The detailed breakdown in Table 3 indicates that a reduction of one to one-and-one-half hours per day is the most popular magnitude of workday reduction. Again ignoring complications

TABLE 2

Preferences of Ontario Employees[a] for Work-Time Reductions

Employment-Sharing Option	Percent Reduction in Work Time[b]	Number of Employees Selecting Option	Percent of Employees Selecting Option	Potential Full-Time Jobs Created[c]	Full-Time Jobs Created as Per cent of Paid Employment
Reduced workweek	19.9	687,100	18.3	136,700	3.6
Reduced workday	17.1	376,400	10.0	64,300	1.7
Increased annual vacation	5.4	746,700	19.9	40,400	1.1
Increased sabbatical leave	8.0	513,400	13.7	40,900	1.1
One or more employment-sharing options	---	1,025,800	27.3	---	---

Source: Unpublished data from Statistics Canada's "Work Reduction Survey," a supplement to the June 1985 Labour Force Survey.

[a] Total Ontario paid employment for the survey month is 3,750,800.
[b] From those who wanted a reduction in work time and pay.
[c] Calculated as the percentage reduction in work time multiplied by the number of employees selecting the option (i.e. column 1 times column 3).

TABLE 3

Preferences of Ontario Employees[a] for Reductions in the Workweek and Workday

Employment-Sharing Option	Per Cent Reduction in Work Time	Number of Employees Selecting Option	Per Cent of Paid Employees Selecting Option	Potential Full-Time Jobs Created[b]	Full-Time Jobs Created as Per Cent of Paid Employment
Reduced workweek					
1/2 day	10.0	164,900	4.4	16,500	0.4
1 day	20.0	410,700	10.9	82,100	2.2
1 1/2 day	30.0	24,100	0.6	7,200	0.2
2 days	40.0	58,200	1.6	23,300	0.6
more than 2 days	50.0	15,100	0.4	7,600	0.2
amount not stated	---	14,200	0.3	---	0.0
Total	19.9	687,100	18.3	136,700	3.6
Reduced workday					
1/2 hour	6.3	96,800	2.6	6,100	0.2
1 to 1 1/2 hours	15.6	175,200	4.7	27,300	0.7
2 to 2 1/2 hours	28.1	65,500	1.7	18,400	0.5
3 to 3 1/2 hours	40.6	14,600	0.4	5,900	0.2
4 or more hours	50.0	13,200	0.4	6,600	0.2
amount not stated	---	11,000	0.3	---	0.0
Total	17.1	376,400	10.0	64,300	1.7

Source: Unpublished data from Statistics Canada's "Work Reduction Survey," a supplement to the June 1985 Labour Force Survey.

a Total Ontario paid employment for the survey month is 3,750,800.

b Calculated as the percentage reduction in work time multiplied by the number of employees selecting the option.

c Total may not sum due to rounding.

in implementation, such workday reductions have the potential to create an additional 64,300 jobs in Ontario, i.e., to increase paid employment by 1.7 per cent.

Increased annual vacation (with a proportionate reduction in pay) is the most popular of the employment-sharing options in Ontario, being selected by almost three-quarters of a million employees (19.9 per cent of all paid employees). The average desired reduction in work time is only 5.4 per cent, however -- the lowest among the four options -- resulting in a potential employment gain of 40,400 jobs (1.1 per cent of paid employment) if such increased annual vacation were implemented. Table 4 indicates that increased annual vacation of one week, two weeks, and one month are all popular, but that the additional month of vacation is the variant with the greatest job-creation potential.

Finally, increased sabbatical leave (with a proportionate reduction in pay) was selected by 513,400 Ontario employees (13.7 per cent of the total). Employees were asked if they wished to take unpaid leave ranging from two months to a year or more. They were also asked the time horizon over which they wanted to take the leave, ranging from periods of one year to seven years or more. The results indicated that the average employee desires a work reduction corresponding to 8.0 per cent of work time, with the potential to create the equivalent of 40,900 full-time jobs. The most popular length of leave is two months or less, as indicated in Table 4, but the length with the greatest potential for job creation is leave of one year or more.[1]

In the United States, broadly similar overall results were obtained in a 1978 survey of approximately 1,000 full-time employees

TABLE 4

Preferences of Ontario Employees[a] for Increased Annual Vacation and Unpaid Leave

Employment-Sharing Option	Per Cent Reduction in Work Time	Number of Employees Selecting Option	Per Cent of Paid Employees Selecting Option	Potential Full-Time Jobs Created[b]	Full-Time Jobs Created as Per Cent of Paid Employment
Increased annual vacation					
1 week	1.9	216,700	5.8	4,100	0.1
2 weeks	3.8	260,400	6.9	9,900	0.3
3 weeks	5.8	67,200	1.8	3,900	0.1
1 month	8.3	146,300	3.9	12,100	0.3
2 to 3 months	20.8	30,900	0.8	6,400	0.2
4 to 5 months	37.5	7,700	0.2	2,900	0.1
6 or more months	50.0	2,100	0.1	1,100	0.1
amount not stated	---	15,300	0.4	---	0.0
Total[c]	5.4	746,700	19.9	40,400	1.1
Increased unpaid leave					
2 months or less	2.5	331,500	8.8	8,300	0.2
3 to 6 months	11.3	84,400	2.3	9,500	0.3
7 to 11 months	22.5	13,600	0.4	3,100	0.1
1 year or more	30.0	66,700	1.8	20,000	0.5
amount not stated	---	17,200	0.5	---	0.0
Total[c]	8.0	513,400	13.7	40,900	1.1

Source: Unpublished data from Statistics Canada's "Work Reduction Survey." a supplement to the June 1985 Labour Force Survey.

a Total Ontario paid employment for the survey month is 3,750,800.

b Calculated as the per cent reduction in work time multiplied by the number of employees selecting the option.

c Total may not sum due to rounding.

designed to be representative of the U.S. labour force. The U.S. survey indicated an even greater magnitude of desired work-time reduction (with proportionate reduction in pay) through a shortened workday, increased annual vacation, and increased sabbatical leave. The U.S. results indicated a somewhat smaller desired work reduction through a shortened workweek (see Reid 1986).

A survey representative of the Quebec population (Bellemare and Poulin-Simon 1983) indicated a somewhat smaller percentage of the population interested in reduced work time (9 per cent), but a survey of the Quebec public service (Acoca 1984) indicated a somewhat larger per cent interest in reduced work time (57 per cent).

Existing Policies to Facilitate Voluntary Work Time Reductions

Two examples of jurisdictions which have recently introduced programs of voluntary work-time reductions for their employees are Santa Clara County in California, and the government of Quebec. In the California program, which began in September 1985, employees could participate for a six-month period in a program allowing reductions of work time by 2.5, 5, 10, or 20 per cent. The employees have the choice of reducing their workday, workweek, or work year by the chosen amount. In March 1985 the government of Quebec implemented a program (negotiated with the employees' union) which allowed a reduced workweek, sabbatical leave, or early retirement. In both jurisdictions the work reductions are subject to the approval of the relevant department administrators.

In 1985 the Quebec government also introduced an experimental program to encourage employment-sharing in the private sector. The Programme d'amenagement concerté du temps de travail (PACTT) provides subsidies for both a preliminary study and the operating costs of

initiatives to reduce work time through reducing the workweek, reducing overtime, reducing the workday, increasing vacation, or offering early retirement.

The idea of extended leaves with a proportionate reduction in pay has been implemented very successfully by the teaching profession through "four-over-five" plans. These deferred-salary leave plans, as they are more generally known, allow a teacher to spread four years' salary over five years, with one year as a (self-funded) leave at 80 per cent salary. Many plans allow a more flexible "X over Y" formula in which, for example, a teacher could spread two years' salary over three years. The plans were introduced in the late 1970s to prevent layoffs of teachers during periods of declining enrolment and to provide teachers with the advantage of greater flexibility in their careers. Contract provisions permitting deferred-salary leave plans became popular very quickly. In 1979, 29 per cent of Ontario teacher-school board collective agreements contained deferred-salary leave provisions, and by 1982 this figure had risen to 74 per cent (Education Relations Commission 1982).

The teacher deferred-salary leave plans have been very well received by the school boards, teachers, and the teachers' unions. From the management viewpoint, the four-over-five plans often permitted the school board to save money by retaining (or hiring) a lower-paid junior teacher to replace a more highly paid senior teacher on leave. In almost half of the deferred-salary leave agreements, the employer continues to pay benefits during the year of the leave. From the union viewpoint, the plans avoid the layoff of junior teachers and give senior teachers an opportunity to tailor their work schedules to their own needs and preferences.

A deferred-salary leave plan for the economy as a whole to facilitate employee skills upgrading was proposed in 1983 by the federal government's Skill Development Leave Task Force, a group composed of representatives from labour, management, government, and the educational system. In the "One-in-Five Option" outlined in their report, Learning a Living in Canada (p.60), the Task Force recommends a policy whereby "an employee may agree to draw a four year salary over a five year period ... to provide a means for employees to access skill development programs ... to more equitably share available work."

An Employment-Sharing Policy for Ontario

In my view, the most significant and innovative policy change the Ontario government could adopt to encourage employment-sharing and reduce unemployment would be to amend the Ontario Employment Standards Act (ESA) to give employees an entitlement to voluntary work time reductions with a proportionate reduction in pay. The principle of an entitlement to work reductions is currently embodied in Part XI of the ESA, which entitles female employees to unpaid pregnancy leave of up to 17 weeks. At the termination of the leave the Act states, the

> ... employer shall reinstate the employee to her position or provide her with alternative work of a comparable nature at not less than her wages at the time her leave of absence began and without loss of seniority or benefits.... (s. 38)

At the federal level, the Canada Labour Code provides 24-week childcare leave which can be taken by either parent in addition to the mother's basic 17-week maternity leave. The principle underlying such legislated parental leave provisions is that childbearing is a

socially useful activity and legislation to reduce the negative effects on parents is warranted, even though it may entail some administrative inconvenience and cost increase for the employer.

When the economy is experiencing deficient-demand unemployment, voluntary leave for any purpose is socially desirable because it has the potential to create jobs. By using an extension of the arguments offered to justify parental leave, the general right to reduced work time could be included in the Ontario Employment Standards Act. To assist employers in adapting work schedules to employees who desire to reduce their work time, employers should be permitted to require written notice up to a specified period (e.g., two months) of a request for a leave or reduced hours. The employer should also be able to require the employee to make a commitment to reduced hours for a minimum period of time (e.g., six months), after which the employee would have the right to return to full-time employment.

A policy of entitlement to reduced work time is attractive in terms of both efficiency and equity. One virtue of such a policy is that compliance is enhanced by the fact that one of the parties (the employee seeking the leave) has an interest in implementing the policy. This is a significant advantage over a policy such as the current overtime permit system, in which neither the employer nor the employee working the overtime has a self-interest in being required to obtain a permit before working overtime.

A work-reduction-entitlement provision in the ESA would be relatively inexpensive to the government since there is no direct outlay of funds. Some increase in administrative costs should be anticipated, however, since some resources would be required for investigation of any complaints by employees that they were

unreasonably denied the right to reduce their work time or were not reinstated without loss of seniority and benefits at the termination of their work-reduction program.

One of the potential drawbacks of a work-reduction-entitlement policy is that there may be difficulties adapting it to changing economic conditions. In theory, the entitlement to leave could be implemented and removed according to the state of the economy, but this is unlikely to happen for two reasons. First, the effectiveness of the policy relies on a widespread awareness among employees of their right to reduced work time, and it would be very difficult to maintain awareness if the rules changed frequently. Secondly, employees who wished to take advantage of the entitlement to reduced time would become a political constituency which would apply pressure to preserve the provision. The political constituency problem, however, is common to many policies implemented to alleviate unemployment (e.g., unemployment insurance benefits). More importantly, if one accepts the numerous forecasts that unemployment will remain a significant problem at least into the 1990s, then the lack of flexibility may not be a serious drawback because circumstances will not call for the removal of the policy for a substantial period of time.

In terms of allocative efficiency, a work-reduction-entitlement policy may raise unit labour costs somewhat, even though income is reduced in proportion to hours, owing to a larger number of employees on the payroll and a resulting increase in benefit costs and training costs. Such a cost increase could, however, lead to an <u>increase</u> in allocative efficiency to the extent that it is correcting an externality (the impact of unemployment on third parties) that is not

otherwise taken into account by the two parties in setting work schedules (given that wage adjustment fails to clear the labour market). In this case, any increase in costs would be analogous to an increase in costs of a firm forced to install pollution control equipment -- i.e., an adjustment which brings price into line with true social costs rather than only the private costs to those directly involved.

There are, however, reasons to believe that the impact on costs would be mitigated by a number of factors. Jobsharing employees, for example, have been found to have lower rates of absenteeism because some absences (e.g., dentist appointments) can be scheduled on non workdays. Jobsharers have also been found to have lower turnover rates and increased productivity as a result of less fatigue (Meltz et al. 1981). Since jobsharing is still a relatively new work pattern, employers may not yet be aware of these advantages and may be unwilling to experiment to acquire the information because of risk aversion and an inability to prevent competitors from emulating successful experiments.

In terms of equity, a policy of entitlement to voluntary work reductions will not eliminate unemployment; however, it may have the potential to create a significant number of jobs, as suggested by the evidence presented earlier in this section of the paper. In fact, the potential for job-creation from the voluntary workweek reductions outlined above is more than double the job creation potential of the complete elimination of overtime work (discussed below). In addition to providing benefits for the unemployed, the work reduction also benefits those employees who engage in it, and although these employees are likely to be in high-income multi-earner families,

their benefit is not at the expense of low-income employees. On the contrary: both those employees who choose the work reduction and those who gain employment benefit from such a policy.

RESTRICTING OVERTIME AND REDUCING THE STANDARD WORKWEEK

An Assessment of Current Employment Standards Legislation

Currently the Ontario Employment Standards Act (section 17) specifies maximum permissible working hours of 8 hours a day and 48 hours per week. It also requires that hours in excess of 44 hours per week be compensated at an overtime rate of one-and-one-half times the regular wage rate. Under Regulation 285, employees in a number of occupational groups are exempted from both the maximum hours and the overtime provisions of the ESA. Many of the excluded occupations are ones for which hours of work are not easily measured or the employees are not closely supervised. Some of the excluded occupations are professional groups (e.g., law, medicine, surveying), teachers, managerial or supervisory employees, firefighters, real estate salespersons and other salespersons who work away from the employer's place of business, employees engaged in fishing and farming, homeworkers, and domestic servants. Some groups (e.g., construction workers) are exempt from the maximum hours but not the overtime provisions. Other groups are exempt from the overtime provisions but not the maximum hours provisions.

The ESA also gives the Director of Employment Standards the discretion to issue permits for hours of work exceeding the maximums of 8 hours per day and 48 hours per week. Under subsection 20(1), so-called "100-hour permits" can be issued which authorize an extra 12 hours per week for specified categories of employees ("engineer,

fireman, full-time maintenance man, receiver, shipper, delivery truck driver or helper, watchman or ... similar occupation") and an extra 100 hours per year for all other employees. Under subsection 20(2), so-called "special permits" can be issued authorizing whatever hours of work the Director of Employment Standards deems appropriate. Special permits sometimes simply specify "hours of work as required," which essentially means no limits are imposed. Even with a permit, however, an employee cannot be required to work beyond 48 hours per week without the consent of the employee or his or her union.

Although the ESA gives the Director of Employment Standards discretion in issuing permits, the practice (at least until 1986) has been to issue 100-hour permits to any employer who applied. These permits are of indefinite duration and are never revoked, with the result that a stock of over 35,000 permits has accumulated in Ontario. More discretion is involved in issuing special permits, which expire at the end of each calendar year.

The Director of Employment Standards has also, under subsections 20(1) and 20(2), issued "industry permits" to 26 industries, covering all employers in the specific industries. The industry permits typically combine a 100 hour-permit and a special permit, of which the most common specification (14 of 26 industries) is "hours of work as required" for particular categories of employees. The special permits issued as part of an industry permit remain in force indefinitely, unlike those issued to individual employers. The 26 industries with permits include, among others, automotive repair and gasoline stations, baking, hotels, motels, restaurants and taverns, urban and interurban transit, laundry and

dry cleaning, mining, retail stores, taxis, logging and sawmills, and heating.

There appears to be widespread noncompliance with the maximum hours provisions of the ESA. Robb and Robb (1987, Appendix on Special Permits) note that special permits authorize about one million excess hours per year; but by looking only at those employees who usually work more than 60 hours per week and excluding occupations and industries with exemptions, it appears that about 25 million excess hours per year are actually worked. Robb and Robb also note that for several reasons their estimates are likely to understate excess hours actually worked. Notably, their calculations exclude employees working more than the 48-hour limit but fewer than 60 hours per week. Applying the Robbs' methodology to the latter group would add another 10 million excess hours per year, for a total of 35 million excess hours.[2] This greatly exceeds the one million excess hours authorized through special permits. The low rate of compliance estimated through this method is consistent with anecdotal evidence on the incidence of noncompliance.

The low compliance with current hours provisions in the ESA may reflect the fact that neither the employer nor the employees working the overtime (providing there is no coercion) have a self-interest in enforcing the provisions of the Act. The individuals with a self-interest in enforcing the Act are the unemployed persons who would be hired if hours of work were reduced. Generally, any particular unemployed individual will not be able to identify any specific job which he or she is being denied as a result of noncompliance, so there is no focus for complaints by the unemployed. An exception occurs when some individuals are on short-term layoff from a firm at

which other employees are working overtime. In this situation, individuals on layoff can easily see the connection between their own joblessness and overtime work by other employees. Such situations have sometimes resulted in appeals to or bitter complaints about those employees working overtime.

Taken together, the factors outlined above (i.e., the automatic granting and irrevocability of 100-hour permits, exemptions for many occupations, permanent industry permits, and widespread noncompliance) suggest that the current provisions of the Employment Standards Act have had very little impact in restraining hours of work in Ontario.

In terms of efficiency and equity criteria, current employment standards legislation does not fare well as a job-creation policy. Since the policy seems to be ineffectual in restricting hours, it does little in terms of promoting equity through creating jobs for the unemployed. On the other hand, its ineffectiveness means that the current legislation is not doing much damage to the efficiency of the economy through disruption of the allocative function of the labour market. Although the current legislation has not been varied cyclically, the lack of flexibility is not disruptive given the ineffectiveness of the policy. Current policy also does not appear to be imposing large administrative costs on either the government or the private parties.

Reducing the Standard Workweek

Reducing the standard workweek appears, at first glance, to be a remarkably potent means of increasing employment because relatively small reductions in average hours translate into very significant

employment gains. For example, if translated into increased employment on an hour-for-hour basis, a reduction in the average workweek from 40 to 39 hours would result in a 2.5 per cent increase in employment. A reduction from 40 to 36 hours per week would translate into an employment increase of 11 per cent (40/36=1.11). There are, however, a number of important problems with attempting to legislate such a reduction in Ontario. The maximum potential impact may be partly offset by imperfect compliance, increased overtime hours, a reduction in total hours of labour employed, and an induced productivity increase.

One problem with legislating a reduction in standard hours is that the standard workweek in Ontario is generally not currently determined by the ESA. The standard workweek refers to the normal hours of work for full-time employees and is usually the trigger for the payment of an overtime premium rate. In the Ontario ESA, the current minimum trigger for an overtime rate of time-and-one-half is 44 hours per week. Almost 85 per cent of major collective agreements in Canada in 1984 specified a standard workweek of 40 hours or less, and 15 per cent had no provision regarding standard hours (Labour Canada 1984). Similarly, the Pay Research Bureau survey of union and nonunion establishments indicates that over 90 per cent of establishments in Canada in 1984 had a standard workweek of 40 hours or less (Pay Research Bureau 1984, p. 95). It is clear that the 44-hour overtime trigger is a superfluous requirement in most medium-sized and large establishments, although it may have more relative importance for small businesses.

A substantial reduction in the overtime trigger of the ESA (to under 40 hours) would be required before it had a significant impact

on most workplaces in Ontario. If such a reduction were legislated, than enforcement of the legislation would be significantly more difficult since it would become a binding constraint on behaviour.

Enforcement would also be difficult because both economic theory and evidence on employee attitudes from the 1985 Survey on Work Reduction (Table 3) indicate that the existing standard workweek reflects the preferences of the employer and the majority of employees. It is notoriously difficult to enforce laws which are contrary to the mutual interest of the two parties involved in a transaction, as the parties have an incentive to find legal or illegal ways to circumvent the intention of the legislation. From the viewpoint of enforcement, it is critical to ensure that one of the two parties has a self-interest in adhering to the provisions of the legislation.

Another problem in legislating a reduction in the standard workweek is that part of the reduction in standard hours may be offset by an increase in overtime hours. In terms of economic theory, two distinct situations need to be considered. In the first situation, in which the employer has some employees in the work group initially working overtime on a regular basis, cost minimization requires that the extra output per dollar must be equal for the last hour of overtime and an additional hour of new employment (otherwise, the employer could reduce costs by shifting from the more expensive alternative to the cheaper one). Since workers are already working overtime and receiving the overtime premium of, say, time-and-one-half, a reduction in the standard workweek has no impact on the cost of an <u>extra</u> hour of overtime work (formally, the <u>marginal</u> cost of additional overtime has not changed). The reduction in the standard

workweek does, however, increase the cost of an additional employee working standard hours because training and other quasi-fixed costs are spread over a smaller number of hours. Since the cost of an additional standard-hour worker is increased relative to the cost of additional overtime hours, the cost-minimizing employer has an incentive to reduce the number of employees working standard hours and increase the amount of overtime of those employees already working overtime. This is, of course, the opposite of the employment impact intended by a reduction of the standard workweek.

The second case to be considered is one in which all employees in the work group are working standard hours. In this situation (a "corner solution" in economic terms), the extra cost of an hour of new employment (including the quasi-fixed costs spread over the expected duration of employment) must be less than the overtime wage rate. A reduction in the standard workweek will, for any given total hours of labour, result in a proportionate increase in employment (unless the reduction is so great it becomes profitable for the employer to begin utilizing overtime).

Another complication results from the fact that reducing the standard workweek may increase unit labour costs and, given a downward-sloping demand for labour, result in a reduction in total hours of labour. This reduction in total hours of labour may reflect a reduction in the firm's sales because of a cost increase and a replacement of labour by capital or other factors of production.

The net impact on employment as a result of decreasing the standard workweek is an empirical question but unfortunately the empirical evidence is unclear. Hart (1986) reviews a number of studies that use aggregate industry-level data and concludes:

> In summary, the employment/hours outcomes from these somewhat aggregate studies with respect to standard hours changes are very inconclusive. The effect of standard hours reductions on employment is found either to be insignificant (a result not inconsistent with the theory) or negative (contrary to the theory).... Perhaps the fundamental message behind the results, however, is that the micro-theory should be tested with far more disaggregated data.

At the micro level Hart relies on his own study (coauthored with Wilson) of the U.K. metalworking industry. Using firm level data, the authors found that the decrease in employment at those firms initially working overtime offset the increase in employment at those firms not initially working overtime, with no significant overall effect, a result in accord with the economic theory. There is some doubt about the relevance of Hart's findings for Ontario, however, for two reasons. First, the U.K. metalworking industry was selected for study because it is an industry with very high overtime usage in a country with the highest overtime use in Europe -- roughly 40 per cent of employees work overtime. In Ontario, where only about 10 per cent of employees work overtime, any negative employment impacts for those working overtime would be much smaller relative to the positive impacts for those not working overtime.

Secondly, the results in the hours equations reported by Hart do not seem consistent with the results in their employment equations. Both the "overtime enterprises" and the "all enterprises" equations show a highly significant decline in hours per worker in response to a reduction in standard hours, contrary to the increase in hours predicted by the theory.

The most robust empirical finding in the studies summarized by Hart is that about one-half to two-thirds of the reduction in standard hours are translated into reduced hours per person. The

remainder is accounted for by an increase in overtime work. The strong results from the hours equations suggest to me that part of the potential impact of a reduction in the standard workweek is likely to be translated into increased employment (even though the attempts to estimate directly the employment impact produced inconclusive results).

If the Ontario ESA were amended to reduce the standard workweek, it would be necessary to take account of the diversity of existing standard workweeks. A single standard, such as a 36-hour week, would have a heavier impact on those employees with a current 40-hour standard workweek than on those employees with a current 37 and 1/2 hour week. This may be inefficient, as Robb and Robb (1987) have suggested, because the greatest burden would be placed on those groups working long hours -- the very people for whom reductions are presumably the most costly (explaining their initial long hours). It may also seem inequitable to impose the burden of hours reductions disproportionately on those employees currently working long hours.

One possible method of addressing this problem would be to establish different standard workweeks in the ESA for different categories of employees. For example, a standard workweek of 36 hours for nonoffice employees and a standard workweek of 32 hours for office employees may be more equitable and more efficient than a single standard.

Extending the argument, one could direct legislation at changes rather than levels in the standard workweek. The principle of controlling changes is used, for example, in legislation concerning rents and wages where there is a great diversity in levels of the variable. In the context of the standard workweek, legislation might

require that the standard workweek be reduced by, say, two hours per week from its level in some base year. This could be more equitable and perhaps more efficient than a single standard workweek, although there may be some practical difficulties in defining the initial standard workweek for each enterprise. In addition, it could create inequities by penalizing those firms that previously followed a conscious policy of having a shorter workweek, perhaps to share the available work. That is, it assumes that the existing workweek of each firm is the best base from which to legislate changes.

Increasing the Overtime Premium

An often suggested policy to discourage overtime work and increase employment is to increase the overtime premium from time-and-one-half to double time or triple time. Robb and Robb (1987) have assessed in some detail the potential employment impact of such a policy on Ontario, and this section will briefly summarize their conclusions. The complete elimination of overtime for hourly paid employees and conversion into new employment on an hour-for-hour basis would, according to the authors, create an additional 56,300 jobs in Ontario; i.e., an employment increase of 1.6 per cent. It should be noted that the potential impact of the complete elimination of overtime is somewhat smaller than the potential impact of a reduced workweek or voluntary hours reductions.

In the absence of reliable Canadian research, Robb and Robb estimate the impact of increases in the overtime premium, using Ehrenberg and Schumann's (1982) study of the relation between overtime hours and the ratio of quasi-fixed costs to the overtime premium. Robb and Robb also calculated the implied increase in

hourly wage costs and, using estimates of the elasticity of demand for labour provided by Hamermesh (1976), estimated the decrease in total hours of labour (scale effect).

Using their best elasticity estimates, Robb and Robb conclude that raising the overtime premium from time-and-one-half to double time after standard hours of work would increase employment by about 0.1 per cent (1987 p. 52). This effect is the net result of a positive impact of about 0.25 per cent as a result of substituting employment for hours, and a negative impact of about 0.15 per cent from the scale effect's reducing total demand for labour. Increasing the premium to triple time would more than double the size of these impacts, i.e., would result in an employment increase of 0.25 per cent. The authors also find that by imposing the overtime premium increase after 44 or 48 hours, employment increases would be of approximately two-thirds and one-half, respectively, of the impact at 40 hours. Robb and Robb also present calculations which indicate that if a much higher elasticity estimate were used (unrealistically high in their view), the estimated employment impact of going to double time after standard hours is raised from a 0.1 per cent increase in employment to a 0.6 per cent increase. Overall, their conclusion is that the potential employment increase from raising the overtime premium is rather small.

The use of the overtime premium does, however, have one important efficiency advantage over the use of a permit system. Using an overtime premium to discourage overtime allows continued overtime work by those firms for which overtime reductions are impossible or extremely costly. A permit system does not have a

built-in safety mechanism to determine which firms most need overtime and allow them to utilize it, albeit at a high price.

Restricting overtime work could also potentially create inequities between families because some families have one income earner and other families have multiple earners. On a family basis, it may be unfair to restrict overtime of a single-earner working 60 hours per week when restrictions would not apply to another family with two earners each working 40 hours per week for a total of 80 hours. Tabulations by the author using data from the Work Reduction Survey indicate this is not a serious problem because empirically the difference in overtime work is small. For Canada in 1985, employees in single earner families averaged 1.15 hours per week compared to 0.95 per week for employees in multiple earner families. Furthermore, the difference in average overtime hours was accounted for almost entirely by a higher incidence of overtime work by single-earners (14.7 per cent vs. 12.4 per cent) rather than longer duration of overtime.

Modifications to the Permit System

The maximum potential impact of eliminating overtime for hourly paid employees (a 1.6 percent increase in employment) provides the upper limit of both the overtime premium policy and the permit policy. If, however, a permit policy is to be maintained, there are a number of ways the operation of such a policy might be improved.

The current pattern of industry overtime permits appears, at least to me, to be rather arbitrary. While every industry may consider itself unique in some respects, it is not clear that the industries with overtime permits are unique in any systematic way

which can justify their exclusion from the overtime provisions of the Act. This situation is not only inequitable, it is possibly unconstitutional if the unequal treatment of employees in these industries has no "reasonable" basis.

Similarly, the exclusion of various occupational groups (e.g., farm workers) under Regulation 285 appears somewhat arbitrary and should perhaps be reviewed and the exclusion eliminated where not justified on a reasonable basis.

The long-standing practice of issuing 100-hour permits of indefinite duration to all employers who apply seems rather pointless. If permits are to be issued automatically, it would be more efficient simply to change the legislation to allow the hours now permitted under the 100-hour permits and to reduce excessive and unnecessary paperwork.

The concept of specifying limits on excess hours on an annual or quarterly basis has much to recommend it, however, when compared with weekly limits as imposed by the 12-hour-a-week excess hours allowed through permits under section 20(1) of the ESA. An annual or quarterly limit achieves the goal of restricting overtime and creating employment but gives the employer greater flexibility in utilizing labour to respond to temporary or unexpected fluctuations in labour requirements. Employees could be protected from being forced to work unreasonably long hours over short periods of time by retaining an overtime premium rate, retaining the right to refuse overtime beyond a certain limit (e.g., the current 48-hour-per-week, limit) and perhaps imposing an absolute weekly maximum (e.g., 60 hours per week).

In my view, the most important single modification to the permit system to improve its operation would be to charge employers for excess hours worked under the permit (for example, at 50 per cent of the hourly wage). Such charges could either be in addition to or instead of the overtime premium. Revenue collected through sale of permits could be used to subsidize employers' quasi-fixed costs and encourage the hiring of new employees (e.g., through reduction of OHIP contributions). Charging for excess hours worked under a permit system has several advantages over the current system. Both the charge for excess hours and the subsidy to quasi-fixed costs encourage the employer to hire new employees to reduce overtime work by current employees. Since the revenue from the selling of permits is returned to employers in general, there is no overall increase in hourly labour costs and hence no negative scale effect reducing employment. (Since the employers will not receive the subsidy in exactly the same amount as their expenditure on overtime permits, some employers will experience a cost increase and some a decrease, but there would be no overall impact on costs).

Charging for excess hours issued under the permit system would also likely result in greater compliance than the current permit system. The Employment Standards Branch would have a greater incentive to enforce the legislation since it would be generating revenue with which to provide subsidies. In addition, employers are likely to take the permit more seriously if a charge for excess hours were involved. Failure to obtain a permit would be akin to tax evasion and would be regarded by all parties as a more serious offence. Most employers have in the past probably perceived (correctly) that they were unlikely to be heavily penalized for

failure to obtain a permit which was issued at no cost automatically to all who applied (at least in the case of 100-hour permits).

At first glance it may seem as if the government, by charging for overtime permits, is licensing an undesirable activity. This could be politically unattractive in the same way that effluent charges are sometimes considered a "licence to pollute." The problem is not likely to be a serious one, however, because the government already licences excess hours through the permit system. Charging for excess-hours permits would be condoning the activity less than the current practice of issuing permits without charge.

An Entitlement to Compensation Time

Providing time off as compensation for overtime work is another policy to create employment. The Ontario ESA could provide for overtime pay to be replaced by compensation time at the mutual agreement of the two parties, at the employee's request, at the employer's discretion, at the request of either party, or compensation time could be required in all cases.

Although forcing employees to take "comp" time has the potential to create more jobs, there is a potential compliance problem when legislation attempts to force behaviour that may be contrary to the self interest of both parties involved. Giving employees an entitlement to compensation time would be superior from a compliance standpoint. The political acceptability of the policy to unions and employees would also be greatly increased if there were no coercion of current employees to take compensation time.

Providing employees with an entitlement to compensation time in lieu of overtime pay is really a special case of the general policy of voluntary work reductions, discussed earlier in this paper. A

special analysis by the author of unpublished data from the June 1985 Labour Force Survey supplementary Survey on Work Reduction indicates that, of the 526,000 Ontario employees working "overtime or extra hours," 148,600 employees, i.e., 28 per cent, want to reduce their work time with a proportionate reduction in pay. The proportion of "overtime or extra-hours" employees who want to reduce their work time is thus very close to the 27 per cent of all Ontario employees who want to reduce their work time with a proportionate reduction in pay. The data suggest that a substantial number of employees now working overtime do not have the option of either refusing to work overtime or reducing their hours through compensation time.

The right to compensation time off could be provided either at straight time or at time-and-one-half or a greater multiple. In my view, compensation at time-and-one-half is more desirable than straight time because it gives the employer an incentive to avoid overtime work. It also, has the potential to create more new jobs when the time off is taken, and it gives the employee a greater incentive to exercise their right to compensation time. Providing compensation time at double time or a higher rate would impose a cost increase and consequent negative scale effect on employment, which, in my view, is too great relative to the typical time-and-one-half overtime pay rate.

POLICIES TO ELIMINATE BARRIERS TO EMPLOYMENT SHARING

Employer expenditure on benefits is an important component of the total compensation package. The Pay Research Bureau data in Table 5 reveal that expenditure on benefits added almost 50 per cent to pay for straight-time worked in Canada in 1984, the most recent year for which data are available.

TABLE 5

Employer Expenditure on Benefits, Canada 1984, Pay Research Bureau Data

	Per Cent of Employees covered by Benefit	Mean Dollars per Employee/yr	Mean Per cent of Pay for Straight-Time Worked
Pay for straight-time worked	100.0	22,377	100.0
Paid time away from duty			
paid holidays	99.7	1,182	5.3
paid vacations	99.7	2,020	9.0
paid sick leave	95.9	492	2.2
paid personal leave	75.5	149	0.7
paid rest periods	90.8	1,060	4.7
Straight-time pay	100.0	27,280	121.9
Pay supplements			
overtime and holiday work pay	97.2	1,120	5.0
shift-work compensation	91.0	169	0.8
Financial benefits			
severance pay	82.5	39	0.2
retirement allowances	87.1	138	0.6
Gross pay	100.0	29,335	131.1
Legislated benefits			
Workers Compensation	95.0	361	1.6
Unemployment Insurance	99.0	567	2.5
Canada/Quebec - Pension Plans	98.7	316	1.4
Group life insurance & related plans	87.9	153	0.7
Health insurance plans			
Provincial health care[a]	98.8	146	0.7
Quebec & Manitoba health care	90.6	246	1.1
Supplementary health insurance	91.6	100	0.4
Dental care plans	96.4	166	0.7
Salary continuation plans			
Sickness indemnity insurance	98.5	49	0.2
Combined sick leave & sickness indemnity	95.6	91	0.4
Long-term disability insurance	93.1	113	0.5
Supplementary unemployment insurance	97.5	12	0.1
Private pension plans	89.9	1,879	8.4
TOTAL COMPENSATION		33,534	149.9

Source: Pay Research Bureau (1984), Employee Benefits and Conditions of Employment in Canada 1984, Table 30-B, p.155, and calculations by the author.

[a] Based on all participating establishments including those located in provinces which do not levy premiums.

When benefit costs are specified on a dollars-per-employee basis rather than a dollars-per-hour basis or a percentage of earnings, benefits become a quasi-fixed cost. Such quasi-fixed costs are an incentive for a cost-minimizing employer to utilize fewer employees and require them to work longer hours per employee than would otherwise be the case.

Provisions of benefits specified in employment standards legislation, collective agreements, or other written or unwritten terms of employment may be inadvertently causing an increase in quasi-fixed costs, leading employers to adopt work schedules with excessively long hours which are both inefficient and inequitable. It is possible that much of this bias toward excessive hours per employee could be removed through minor modifications in policies governing benefit costs.

Table 5 indicates that pay for time not worked adds over 20 per cent to pay for straight-time worked, primarily through vacation, public holidays and paid rest periods. The Ontario Employment Standards Act (section 29) specifies that:

> (1) Every employer shall give to each employee a vacation with pay of at least two weeks upon the completion of each twelve months of employment.
>
> (2) The amount of pay for such vacation shall be not less than an amount equal to 4 per cent of the wages of the employee in the twelve months of employment for which the vacation is given.

Since the ESA specifies vacation pay as a per cent of earnings, it is not a quasi-fixed cost. If an employee works long hours his or her earnings will be increased and vacation pay will be increased proportionately. The ESA vacation pay provision thus gives no

incentive for employers to work their employees longer hours to save on vacation pay.

The Ontario ESA holiday pay provisions, in contrast, do provide an employer with an incentive to use excessively long hours to reduce costs. Subsection 26(2) of the ESA requires the employer to provide each employee with a minimum of seven holidays each year (New Year's, Good Friday, Victoria Day, Canada Day, Labour Day, Thanksgiving, and Christmas) "... and pay to the employee his regular wages for each public holiday." Since the holiday pay provisions refer to "regular wages" rather than a percentage of earnings, holiday pay provided under the ESA becomes a quasi-fixed cost. For example, an employer with three employees working 40 hours per week will spend 50 per cent more on holiday pay than an employer with two employees working 60 hours per week. This bias toward reduced employment and long hours could be corrected by modifying subsection 26(2) of the Act to read "... and pay to the employee an amount not less than 5.0 per cent of his or her earnings in the four-weeks preceding the holiday."

The ESA public holiday and vacation provisions are minimum standards only -- the vast majority of collective agreements or other employment contracts provide more generous benefits. For example, most employment contracts provide nine or more paid holidays, adding to the seven statutory holidays two or more of Boxing Day, Easter Monday, the local Civic Holiday, Remembrance Day, or other holiday (Pay Research Bureau 1984, pp. 101-102). To ensure that all holiday provisions in employment contracts are variable costs rather than quasi-fixed costs, it would be desirable to add a provision to the ESA specifying that "each paid holiday provided by the employer shall

be compensated at a rate not less than 5.0 percent of the employee's earnings in the four-week period preceding the holiday."

Similarly, employment contracts typically provide three or more weeks' vacation for employees after one, three, or five years of service (Pay Research Bureau 1984, pp. 106-107). To ensure that vacation provisions are variable costs rather than quasi-fixed costs, the ESA should be amended to specify that "each week of paid vacation provided by an employer shall be compensated at a rate not less than 2 per cent of the employee's earnings in the 50 week period preceding the vacation."

Paid sick leave provided by the employer is normally self-insured; that is, the employer does not contract with an outside company for insurance. To ensure that paid sick leave and paid personal leave are not quasi-fixed costs, it would be desirable to include provisions in the Ontario ESA specifying that, where an employer provides such leaves, the employee shall be compensated at a rate proportional to his or her earnings in the preceding four weeks. It is not desirable to specify the proportion as 5 per cent per day of leave because this would imply full compensation. Benefits at 100 per cent of earnings are provided by only about one-half of current sick leave plans (Pay Research Bureau 1984, p.61).

Severance pay and retirement allowances typically involve a specified number of days pay per year of service (e.g., five days' pay per year of service). Such costs are quasi-fixed since a "day's pay" will be a regular day's pay and will not be affected by the number of hours per week an individual works. Such plans can be converted from quasi-fixed to variable costs by including a provision in the ESA providing that where an employer provides severance and

retirement allowance, each day of compensation shall be at a rate not less that 5 per cent of the employee's earnings in the preceding four-week period.

Overtime pay and shift-work premiums are automatically related to hours of work and so do not constitute quasi-fixed costs.

Employer contributions to Workers' Compensation (WC), Unemployment Insurance (UI), and the Canada Pension Plan (CPP) are specified as a percentage of earnings up to a ceiling level of earnings per employee (e.g., the UI contribution ceiling was $490 per week per employee in 1986). For employees earning below the ceiling, contributions vary proportionately with hours worked and are therefore a variable cost. For employees earning above the ceiling, however, the contributions are fixed at the ceiling level and the expenditure becomes a quasi-fixed cost. In such a case the UI, CPP, or WC premium provides an incentive for the employer to work existing employees longer hours (since no additional contributions are required) rather than hire new employees (for whom additional contributions would be required).

Employer contributions to WC, UI, and CPP could be converted to a pure variable cost by simply removing the ceilings. Such a change would ignore the original purpose of the ceilings, however, which is to prevent employees with very high incomes from receiving an unseemly high level of benefits from WC, UI, or CPP. Rather than eliminate the ceilings, a more appropriate solution is to <u>prorate</u> the ceilings according to the number of hours worked. If for example the UI ceiling of $490 per week applies to a full-time employee working 40 hours per week, the ceiling would be reduced to $245 for a job-sharing employee working 20 hours per week and increased to $735 for

an employee working 60 hours per week. Prorating the ceiling according to hours worked is equivalent to specifying a ceiling in terms of hourly earnings instead of weekly earnings. In the UI example, the ceiling level for hourly earnings would be \$490/40 = \$12.25 per hour. For employees with hourly earnings above the ceiling, employer contributions would vary proportionately with hours worked, converting UI contributions to a pure variable cost.

Specifying a ceiling in terms of hourly rather than weekly earnings is desirable on equity grounds because hourly earnings provide the better measure of economic power and ability to pay. The problem with weekly earnings is that it ignores the economic value of leisure time. Two people may have equal weekly earnings, but one may have worked 40 hours and the other only 20 hours with the latter enjoying an extra 20 hours of leisure each week.

Changing the structure of the Workers' Compensation premium to prorate the ceiling on earnings subject to contribution is within the jurisdiction of the Ontario government, but prorating the earnings ceilings on UI and CPP would require the cooperation of the federal government.

Group life insurance, sickness indemnity insurance, and long-term disability insurance plans typically specify an insured amount which is a percentage of salary (Pay Research Bureau 1984). To ensure that premiums for these insurance plans are a variable cost rather than a quasi-fixed cost, it is necessary to relate benefits and premiums to total earnings in the previous year rather than to regular earnings. Since the premium structure is determined by an independent insurance carrier, however, legislative intervention may need to be more complex than a simple amendment to the ESA.

The premium for the Ontario Health Insurance Plan (OHIP) is specified on an individual or family basis and is thus a quasi-fixed cost to the employer. The financing of OHIP is a component of the controversial issue of health policy, and it is likely that considerations pertaining to the labour market will be given rather low priority in discussions of health policy. Still, it is perhaps worth noting that the current premium structure provides an incentive for employers to reduce employment and require longer hours of work from existing employees. This bias could be eliminated if OHIP were financed by a payroll tax rather than by premiums. The Quebec and Manitoba governments use a payroll tax (1.5 per cent of earnings in Quebec) to finance the employer contribution to the provincial health plan. From a labour market viewpoint, a payroll tax is more efficient because it does not artificially induce long hours of work and low employment. It is also more equitable because it replaces a regressive head tax with a proportional earnings tax.

Defined contribution pension plans which require contributions based on a percentage of the employee's earnings (including overtime) would be a variable cost. The vast majority of pension plans, however, are defined benefit plans in which the level of benefits is specified as a percentage of earnings over the average of the employee's best x years, the last y years, or the employee's entire career. Employers are obligated to contribute sufficient funds to provide the negotiated level of benefits. If employees work long hours, their increased earnings will increase their entitlement to benefits on retirement and require an increased contribution from the employer to provide that benefit level only if they are in their last x or last y years. The implication is that employer contributions to

defined benefit pension plans may or may not be variable costs depending on particulars of the plan and employee circumstance. It is not clear to what extent short-run decisions concerning hours of work will take into account long-run implications for pension entitlements. To ensure that pension contributions are effectively a variable cost it would be desirable to ensure that contributions are proportional to current earnings.

SUMMARY

The main conclusions and recommendations contained in the report are the following:

- The work-time reduction policies assessed in this paper complement the long-term reduction in working time which has occurred over the last century. However, the policies assessed are primarily directed mainly at creating jobs during temporary periods of deficient-demand unemployment.

- Policies to reduce work time can contribute to both efficiency and equity. The failure of the wage rate to clear the labour market during periods of deficient-demand unemployment means that an "externality" exists whereby employers and employees have no economic incentive to take account of the impact of their work-time decisions on the unemployed or taxpayers generally. Government intervention may be required to correct this externality and contribute to efficiency in the labour market.

- An anomalous situation currently exists in which more than one million paid employees in Ontario (over 25 per cent of paid employees) want to reduce their work time with a proportionate reduction in pay at the same time that a significant fraction of the labour force is unemployed.

- A significant and innovative policy change which the Ontario government could adopt is to amend the Employment Standards Act to give employees an entitlement to reduce work time voluntarily with a proportionate reduction in pay. The employees could elect work-time reduction through a reduced workday or workweek (jobsharing) or increased unpaid annual vacation. They could also elect to take a deferred salary leave (sabbatical) in which, for example, they spread four years' income over five years and receive a year leave at 80 per cent of salary. Such leaves have been implemented very successfully in the teaching profession through "four over five" plans.

- The job creation potential of such voluntary work reduction plans is striking (and substantially greater than through policies to restrict overtime work). For example, allowing employees who want to reduce their workweek with a proportionate reduction in pay to do so has the potential to create an additional 137,000 jobs in Ontario (i.e., a 3.6 per cent increase in employment).

- The concept of entitlement to voluntary unpaid work reductions for socially useful purposes is already contained in the maternity leave provisions of the Ontario Employment Standards

Act. The policy of entitlement to voluntary work reductions recommended in this report is merely an extension of the reasoning used to justify maternity leaves.

- Regulation 285 under the Ontario ESA currently excludes a number of occupational groups from the hours and/or overtime provisions of the Act. In addition, employers in 26 industries have permanent permits which significantly relax the provisions of the Act. The list of industry and occupational exclusions appears rather arbitrary and may constitute an inequitable treatment of employees in those industries. The unequal treatment of employees in these industries may also be unconstitutional unless it can be demonstrated that such treatment is reasonable. All the industry and occupational exclusions of the Ontario Employment Standards Act should be carefully reviewed, and exemptions which no longer have a strong justification should be eliminated.

- There appears to be widespread noncompliance with the current requirement of the ESA that employers obtain permits to authorize work beyond 48 hours per week. Data from the Labour Force Survey indicate that, even after allowing for occupation and industry exclusions and the stock of "100-hour" permits, the quantity of excess hours actually worked is 25 to 35 times that authorized by special permits. The low degree of compliance with the current permit system may be due to the fact that neither the employer nor the employees (nor, for that matter, the Employment Standards Branch) has an economic incentive to ensure compliance.

- If a permit system is to be retained, the current system should be abolished and replaced by a system which focusses on the annual or quarterly total of hours beyond some weekly benchmark (e.g., a permit authorizing up to 250 hours per year of "excess hours" beyond, say, 44 hours per week).

- Employers should be charged for all excess hours used that exceed those allowed under the permit system (e.g., 50 per cent of the wage rate). The revenue generated by this levy on excess hours should be returned to the labour market through subsidies of the quasi-fixed costs of employment (e.g., OHIP premiums or hiring costs) to prevent an overall rise in hourly labour costs. A revenue-based permit system would give the Employment Standards Branch an economic motive to ensure compliance and would likely cause employers to take the system more seriously because using excess hours without a permit would be akin to tax evasion.

- Increasing the overtime premium from time-and-one-half to double time or even triple time produces surprisingly small employment impacts, generally less than 0.5 per cent of employment. The reason for the small impact are that the full-time job equivalent of overtime work subject to the ESA is only about 1.6 per cent of employment; increasing the overtime premium causes only part of this overtime to be substituted for increased employment; and the increase in hourly wage costs reduces total hours of labour demanded (through the scale effect), partly offsetting increases through the substitution of employment for overtime hours.

- Reducing the standard workweek has a large potential impact on employment because such a large fraction of employees would be affected. The current 44-hour overtime trigger is probably not a binding constraint in many workplaces. The standard workweek is typically 37 1/2 or 35 hours in office jobs and 40 hours in nonoffice jobs. If the Ontario government decided to reduce the standard workweek to increase employment, an allowance would need to be made for the current diversity of standard hours. The standard workweek could, for example, be set at 36 hours per week for nonoffice employees and 32 hours per week for office employees so that both groups would be affected by a similar magnitude.

- Economic theory and empirical evidence suggest that a significant proportion of the potential employment increase of a reduced standard workweek would be offset by increased overtime work, increases in hourly labour costs, induced productivity increases, and incomplete compliance with the legislation. The evidence suggests, however, that about half of the potential increase would be translated into increased employment, which could still be a substantial impact.

- Reducing the standard workweek imposes work reductions on employers and employees who may not want the reduction. In terms of efficiency, equity, and political acceptability, a policy of entitlement to <u>voluntary</u> work-time reductions may be more appealing.

- Giving employees an <u>entitlement</u> to compensation time off in lieu of overtime pay is an attractive policy in many respects.

It has a relatively high degree of expected compliance because one of the parties (the employee desiring the time off) has an interest in ensuring compliance. This policy is really a special case of the more general policy of entitlement to voluntary work-time reductions.

- Benefits are an important element of total compensation, and a substantial number of benefit provisions in the ESA and in private-employment contracts are (inadvertently) specified in a manner which makes them quasi-fixed costs. The ESA should be amended to ensure that benefits in employment contracts are related to an employee's actual earnings rather than regular earnings. Minor modifications, as suggested in the final section of this report, have the capacity to convert benefits worth several thousand dollars per year per employee from quasi-fixed to variable costs. These changes could significantly reduce the incentive which currently exists for employers to require long hours of work rather than hiring new employees.

NOTES

1. In calculating the percentage work reduction corresponding to each option, the midpoint of each category was used. For the open-ended categories (4 or more hours per day, 6 or more months per year, and 1 or more years of sabbatical leave), the minimum of the category was used. Individuals who indicated they wanted to reduce their work time using a particular option but did not indicate the amount of the desired reduction were counted as not desiring a work reduction. The calculated work reduction will be biased downward as a result of the latter two adjustments, but the amount of the bias is likely to be small.

2. Unpublished Labour Force Survey data (see Reid 1987b) indicate that 204,000 Ontario employees worked between 49 and 59 hours per week. Following the methodology, outlined in Robb and Robb (1987) this figure is multiplied by 0.47 to eliminate salaried employees and then by 0.50 to eliminate excluded occupations and industries, resulting in an estimate of 47,940 covered employees working between 49 and 59 hours. These employees are assumed to average 54 hours per week (the midpoint of the range) implying a 4-hour per week excess over a 50-hour maximum (i.e., 48 hours per week plus 2 hours per week through 100-hour permits averaged over 50 weeks). The implication is that annual excess hours for this group are approximately 10 million (i.e., 47,940 employees times 4 hours per week times 50 weeks per year = 9,588,000 hours).

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